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Employee Benefits News

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Update: reform of executive remuneration

The Department for Business Innovation and Skills (BIS) has announced its revised proposals on the reform of executive remuneration for quoted UK companies. BIS believes the reforms will strengthen the hand of shareholders in challenging excessive remuneration whilst not imposing unnecessary regulatory burdens. There are a number of differences between the revised proposals and those which were consulted on previously, particularly in relation to shareholder voting powers. Some of the revised proposals may be more palatable to companies. However, the proposals still represent a significant increase in shareholder power and some of the new requirements may cause controversy in practice.

Key issues

- Executive remuneration disclosure
- Revised proposals on shareholder voting powers

Executive remuneration disclosure

On 27 June 2012 BIS issued for consultation draft regulations on the disclosure of executive remuneration. The revised reporting regime (which replaces the existing reporting regime in its entirety) will take effect for reporting years ending after October 2013.

As previously announced by BIS, the directors' remuneration report will contain two separate parts: a forward-looking section on proposed remuneration policy and a backward-looking section reporting on the implementation of the remuneration policy in the relevant financial year. In addition, the report must include a statement by the chairman of the company summarising the contents of the report.

The review of the financial year will have to include a number of statements, including (1) the total remuneration of each director shown as a single figure (see further below), (2) details of termination payments paid to directors and (3) a line graph showing the total pay of the CEO and the company's TSR over the previous 10 years.

One of the more controversial aspects of the new regime is the "single figure" disclosure, which will relate to "the actual figure earned rather than potential pay awarded". This means that the figure must include, amongst other things, salary, taxable benefits, cash dividends received in relation to LTIP awards, bonuses for the year (including any amount deferred) and LTIP awards where the final vesting is determined as a result of the achievement of performance conditions that end in the financial year being reported on. The value of LTIP awards will be based on the aggregate market value of the shares that have vested. If vesting has not occurred by the time the report is signed off, then an estimated value must be disclosed based on the average market value of the shares over the three month period prior to the financial year end. (A similar approach will be adopted for option plans, with a reduction for the aggregate exercise price).

The future remuneration policy section of the report must include (amongst other things) disclosure of (1) a "future policy table" with a description of each of the elements comprised in the remuneration package, their maximum potential value and how future remuneration policy relates to the company's strategic objectives, (2) estimates of future payouts based on different performance scenarios, (3) the policy for termination payments and (4) the percentage change in profits, dividends and overall expenditure on pay for the reporting period as compared to previous years.

The future remuneration policy section of the report will only be required as and when the company is putting it to a shareholder vote (which in principle may only need be once every three years – see further below).

BIS is expecting that the regulatory requirements will be supplemented by guidance on the level of detail and type of information to be disclosed (particularly in relation to the "future policy table" referred to above) to be agreed jointly between companies and investor communities and that this guidance will be in place before the regulations come into effect.

The BIS consultation is open until 26 September 2012. We will be submitting our comments on the consultation. We are happy to discuss your responses to the consultation with you or to make submissions on your behalf, either on a named or no-names basis.

Revised proposals on shareholder voting powers

In relation to shareholder voting powers, the Government has tabled a number of amendments to the Enterprise and Regulatory Reform Bill, which is currently passing through Parliament. As previously announced, there will be a binding "forward-looking" vote on directors' remuneration policy. This vote need only take place once every three years and not annually as originally proposed. BIS hopes that this revised proposal will encourage companies to take a longer-term view when it comes to developing remuneration policies. Once the forward-looking policy has been approved, then only remuneration which is compliant with that policy may be paid. If a company wishes to change its remuneration policy (or to make a non-compliant payment) within that three-year period, then it will need to seek re-approval for that revised policy/payment from shareholders. Directors authorising any payment in breach of these rules will be liable to indemnify the company for any loss resulting from it. The binding vote will only require a simple majority and not the 75% majority as originally suggested by Vince Cable.

The original consultation proposed a binding "exit payment" vote on directors' termination packages of more than one year's salary. The practicalities of such a requirement came under detailed scrutiny during the consultation and this has resulted in a significant change of approach. Instead of a binding exit vote, companies will be required to set out their approach to termination payments as part of their future remuneration policy, which is then subject to the binding vote referred to above. Only payments which comply with this exit payment policy can then be made. In the event of a director leaving, companies will also be required to issue a statement immediately setting out the amount of the termination payment and how it has been calculated.

As is currently the case, there will be an annual advisory "backward-looking" vote on the implementation of the remuneration policy. (Details of any termination payments will be included in this part of the report and therefore subject to this vote). Under a new requirement, if the advisory vote fails, then this will trigger a binding vote on the remuneration policy in the following year (even if no change in remuneration policy is being proposed).

BIS has stated that the provisions on shareholder voting powers are expected to be implemented on 1 October 2013. Under the current draft of the Bill, certain transitional provisions will apply and payments required to be made under an agreement entered into before 27 June 2012 are excluded. As noted above, companies will need to apply the revised reporting regulations for financial years ending after October 2013. This will mean that the first binding votes on directors' remuneration policy will take place at shareholder meetings in 2014. What remains less clear, however, is whether the first binding votes will relate to remuneration policy for 2014 or 2015. We will update you as soon as we have further details.

Separately, the Financial Reporting Council has announced that it is to consult in the future (after the legislation and regulations referred to above have been finalised) on a number of issues in relation to the UK Corporate Governance Code, including (1) extending claw-back provisions for remuneration and (2) requiring companies to make a public statement on how they intend to address shareholder concerns where a substantial minority of shareholders vote against one of the resolutions on remuneration.

Government launches consultation on tax approved share plans/EMI

In our April 2012 newsletter we reported on the Office of Tax Simplification's (OTS) recommendations for the reform of tax approved share plans/EMI. At the end of June 2012, the Government issued its formal response to the OTS recommendations and launched a consultation which is open until 18 September 2012.

Some of the OTS recommendations have been rejected outright on the grounds of cost to the Exchequer. For example, the Government has rejected the OTS recommendation that the 5 year tax-free holding period for SIP be reduced to 3 years (which would then align it with the tax-free period for Sharesave and CSOP). This is disappointing, but not surprising, given the current economic environment. However, there are two main OTS recommendations that the Government has committed to pursue.

Self-certification

First, the Government agrees with the OTS that the present HMRC approvals process for SIP, Sharesave and CSOP should be replaced with a "self-certification" system. The Government intends to implement the self-certification system from 2014. The consultation therefore asks a number of detailed questions regarding how self-certification should operate in practice and what safeguards should be put in place to protect companies and employees (and advisers !!). For example, should HMRC provide some kind of advance assurance service?

CSOP

Second, the OTS recommended further investigation into the relevance of CSOP. The Government has accepted this recommendation and says that it will take into account evidence already available to it on the current use of CSOP by companies. However, the Government would also welcome "any new economic evidence" on whether CSOP as currently used:

- has a positive effect on productivity and economic growth; and
- addresses market failures and supports Government objectives in a cost effective and targeted way that justifies support through the tax system.

The outcome of the Government's work in this area will be announced during Autumn 2012, for consultation "where appropriate". At this stage the Government is not taking forward the OTS recommendation that CSOP should be merged with EMI. It seems, therefore, that the future existence of CSOP is far from guaranteed. This will be of concern to many companies which currently use CSOP, whether on its own or as part of a suite of employee share plans.

The Government is also consulting on a number of simplification measures. These include (1) adopting some form of harmonised approach to retirement good leaver provisions (and perhaps also harmonised provisions for all categories of good leaver) across all of the approved plans and (2) abolishing the Sharesave seven year savings contract. The Government plans to report back on these simplification proposals in the Autumn and include draft legislation in the 2013 Finance Bill.

Many of the simplification measures will be welcomed by companies. However, as noted above, the possible abolition of CSOP will be of concern. Companies will also want to ensure that any move to self-certification will have sufficient safe-guards to minimise the risk of e.g. unexpected PAYE/NICs liabilities.

We will be submitting our comments on the consultation, including in relation to the continued relevance of CSOP. We would welcome your thoughts and experience on CSOP so please do get in touch with us on this and/or in relation to any of the other proposals.

Update on OTS proposals for unapproved share plans

Having concluding its review of approved share plans/EMI earlier in the year, the OTS has now turned its attention to unapproved share arrangements. Although the initial terms of reference for this review have been published, the breadth of the review is not as clearly defined as it was for tax approved plans. This perhaps reflects the wide variety and complexity of unapproved arrangements which currently exist.

The review of unapproved share plans has therefore been split into two stages. The first stage is a fact-finding exercise to assist in identifying, amongst other things, the types of unapproved share arrangements used by companies, and which parts of the tax/PAYE/NICs systems help or hinder those arrangements.

The second stage of the review will consist of a detailed examination of the priority areas for simplification as identified by the fact-finding exercise. At that stage the OTS intends to finalise its terms of reference. Recommendations are expected to be published by the OTS by Budget 2013.

We will keep you updated with any further developments.

Changes under PAYE – important consequences for employee share plans

Real time information

HMRC is currently implementing a brand new PAYE reporting system known as "real time information" ("RTI"). Under RTI the general rule is that all employers must send a detailed information return to HMRC every time a payment is made to an employee. The information return must be submitted to HMRC on or before the actual date of payment. This means that companies will need to send an information return to HMRC on (or before) every payroll date (usually every month, but possibly weekly or fortnightly for some companies).

However, in practice not all payments are made on the normal payroll date. For example share awards can vest, or options can be exercised, on some date other than the normal payroll date. In these cases it would be extremely difficult for employers to fulfil the timing requirements of RTI. Therefore, after much lobbying, HMRC has agreed to an exception from the general rule for employee share plans. In the case of employee share plans the return will not have to be submitted to HMRC until the 19th of the tax month following the tax month in which the relevant event occurs.

It will be extremely important for employers to ensure that they meet the relevant RTI reporting deadlines (for both cash payments and share plans) as HMRC is currently proposing to bring into force penalty regimes for both inaccurate RTI returns and late RTI returns.

It is also important to bear in mind that one of the reasons for the introduction of RTI is so that it will be easier (and quicker) for HMRC to determine whether or not it needs to charge penalties for late in-year payments of PAYE. With this in mind, HMRC is also currently consulting on a number of changes to the existing penalty regime for late in-year payments of PAYE.

The RTI regulations have already been brought into force, but currently they only apply to employers who are taking part in a HMRC RTI pilot scheme. However, most employers will be required to comply with RTI from April 2013 and by October 2013 it will be compulsory for all employers.

If you would like to discuss RTI in the context of your employee share plans, please get in touch.

The 0T Code

Since 6 April 2012 employers have been required to operate PAYE on post-P45 share-based payments using the "0T" Code (employers were already required to apply the 0T Code to post-P45 cash payments). The 0T Code means that employers must withhold tax at the basic higher and additional rates as appropriate, on a non-cumulative basis.

Shortly after this new requirement was brought into force, HMRC issued a question and answer paper (Q&A) on the practical operation of the 0T Code. In that Q&A HMRC confirmed that the 0T Code should be applied separately to each share-based payment, even if made in the same pay period and by the same entity. This meant that an ex-employee could benefit from the basic and higher rates being applied to more than one share-based payment in the same pay period. However, HMRC has recently issued a revised version of its Q&A. The revised version states that where "administratively practical" to do so, two or more share-based payments made in the same pay period should be aggregated before the 0T Code is applied. However, HMRC provide a number of examples in the Q&A where it accepts that it would not be administratively practical to add share-based payments together. These include (1) where an individual is a participant in multiple share plans which have different administrators and (2) where administrative systems in place cannot readily add together payments of this type. Moreover, HMRC has said it does not expect employers or administrators to actively evidence the practicability of administrative systems when operating the 0T Code.

If you have any queries as to how the 0T Code should be operated, please get in touch.

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Enhancement to EMI

In our April 2012 newsletter we reported that the Government had announced that it would be increasing the individual grant limit under EMI from £120,000 to £250,000. This increase has now been enacted and applies to EMI options granted on or after 16 June 2012.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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